RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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Dec. 18, DJIA 875.76; PTI 1435; A-D Ratio –23.00
Dec. 24, DJIA 873.38; PTI 1414; A-D Ratio –23.42

THE MARKET: According to Dow's Theory, the movements of the D-J Industrial and Transportation Averages provide a composite index of all the hopes, disappointments and knowledge of everyone who knows anything of financial matters. For that reason the effects of coming events (excluding acts of God) are always correctly anticipated in advance.

This is the basic concept as put forth by Charles Dow, William Hamilton and Robert Rhea. I believe this concept is as valid today as when it was first conceived almost one hundred years ago.

Rhea added that the Averages are totally self-adjusting. They adjust for dividend payments, stock splits, stock extras, inflation, deflation, everything. "But," objects the modern investor, "isn't the inflation-adjusted Dow now selling for around 300?" Yes, I answer, but forget inflation adjusting. The fact is that the Dow hit a high of 891.71 in 1964, and here we are 18 years later, and the Dow is actually lower. That's all the information you need to know.

The dismal fact is that for 18 years the Dow has failed to go anywhere. Which tells us that there are problems facing the nation's corporations, ominous problems that have not been solved. This is what the Dow has been facing and discounting – and inflation is just ONE of those problems (although perhaps the most visible one). The Dow is telling us that the thirty giant corporations are collectively worth no more today than they were in 1964 and the reasons are *many*, including inflation, rising Russian world military domination, rising foreign trade competition, rising US debts and deficits, rising corporate pension fund liabilities, rising state and federal power over US business – and a host of other items.

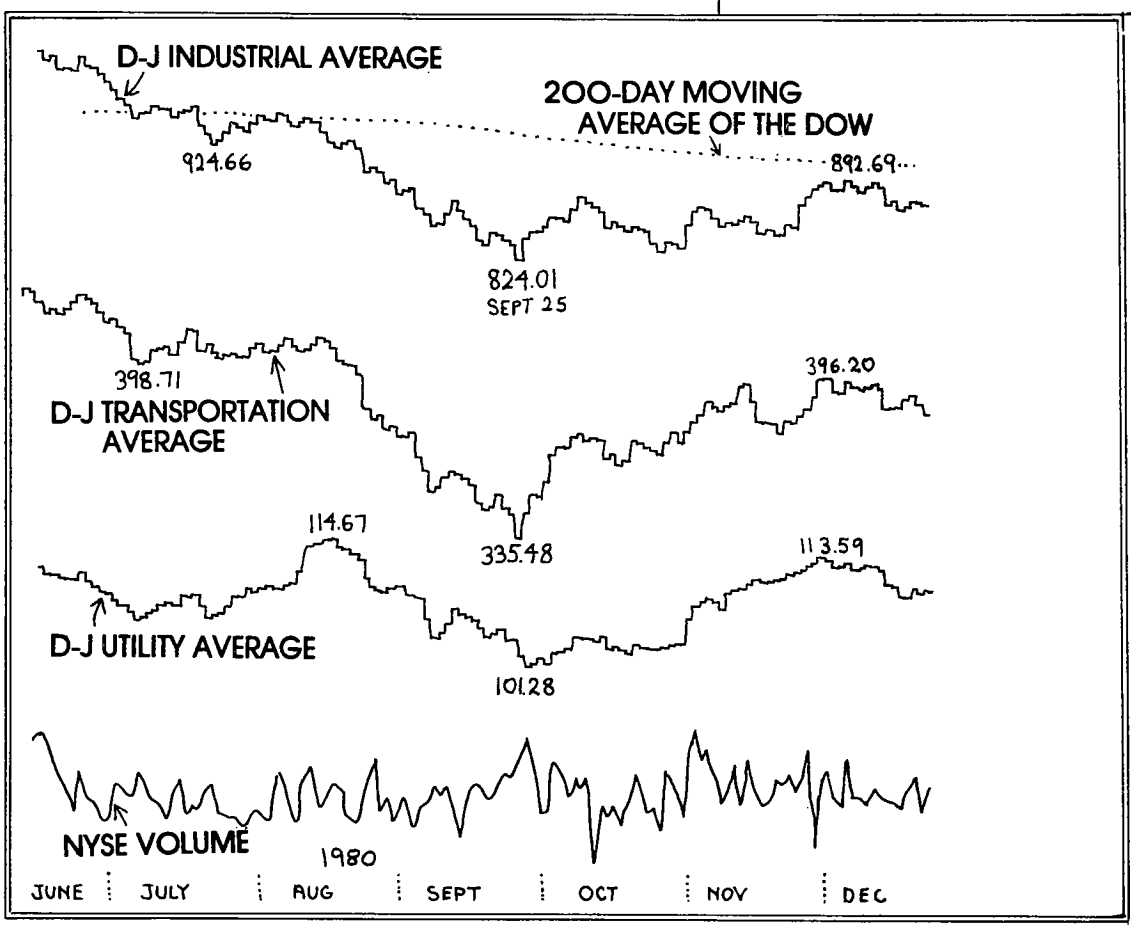
Never tell the Averages how or what to adjust to. They'll do their own adjusting (as the Dow has done). It's our job to analyze and unravel the story in the Averages – not to argue with it.

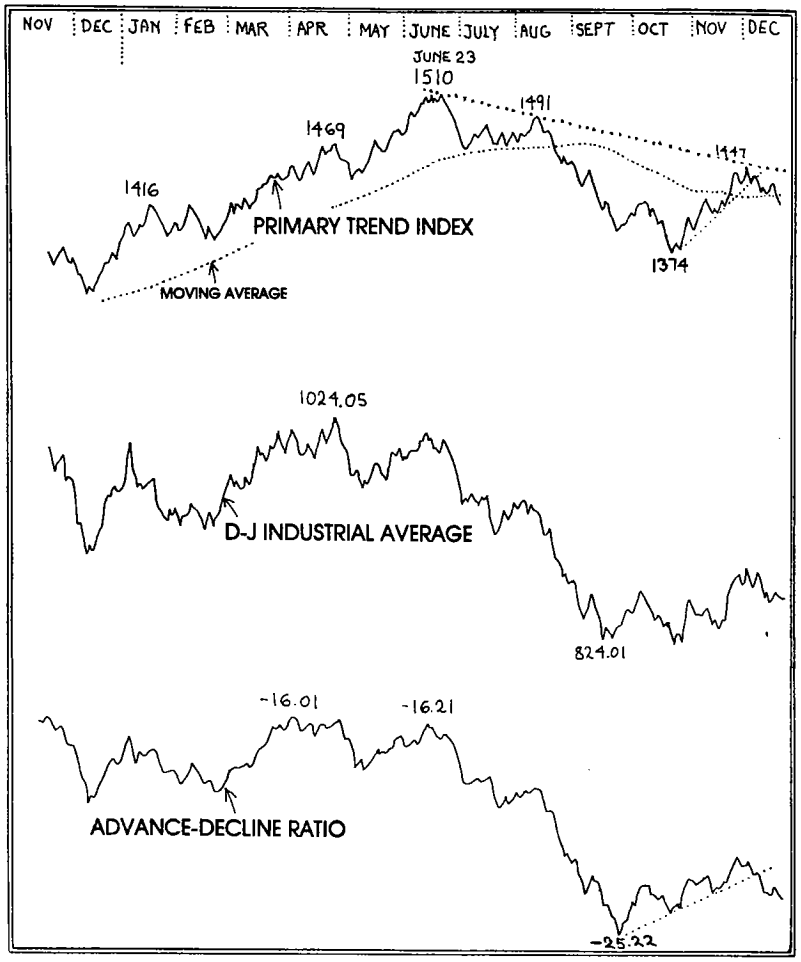
With this in mind please study the chart at left. Following a primary bear signal given in July, the Averages sank to Septem-

FRONT PAGE COMMENT: Economists and Administration spokesmen are vying with each other in predicting "the end of the recession." *Fortune* magazine shows three top forecasting firms (Chase Econometrics, Data Resources, Townsend-Greenspan) *all* predicting a low for the economy in second quarter 1982, then a steady rise during the rest of 1982 and throughout 1983.

Personally, I am wary of the consensus. I am of the opinion that this nation is still in the grip of a recession that began in 1980. (I don't believe that recession ever ended). And I think the current downturn is going to prove more difficult and much more persistent than anything the economists are planning on.

Here are a few observations: over the years the American public has become (of necessity) increasingly knowledgeable and sophisticated about economic affairs . And I believe the voters are taking a very dim (bearish) view of the current trillion dollar US debt and the emerging string of additional deficits. The average American can add two and two, and he knows a political lie when he hears one. Thus the latest Washington chorus to the effect that the new multi-billion dollar deficits "aren't important" strikes the citizen as a dangerous deceit. Consequently, Americans are building economic storm shelters. I think we are moving into an era of lowered expectations and reduced standards of living. Americans sense it – even if the experts do not.





ber 25 lows (Dow 824.01). From there the two Averages rallied. In rallying, the Averages have corrected their severe April to September declines. As of this writing, Industrials have recouped about one-third of their April-September losses. Note, however, that Industrials are still well *below* their 50-week moving average. Transports hit a recovery high of 394.06 on November 12, and they have dropped about 15 points since then.

The Averages are currently far below their highs of last April. But it is a fact that the two Averages are also above their September lows. Thus, the two components are in "no man's land," that territory below the last major highs but above the last primary lows. This no-man's land or secondary territory is the most *difficult and frustrating* for the market student.

When the market is meandering through secondary territory it is really telling us, "I don't know, I haven't made up my mind yet."

What does Dow's Theory say in a situation like this? The Theory says that the major trend is taken to *remain intact* until reversed by a valid signal. So the course remains clear for followers of Dow's Theory. The last primary signal came in July when the tide turned from bull *to bear.* Industrials are now about 50 points above their September 25 low while Transports are 55 points above their own September 25 low. As long as one or both Averages hold above those lows – the bulls are entitled to hope and dream. But a breaking of BOTH of those lows would reconfirm the primary bear trend and signal continued trouble for the stock market and the economy.

Item: the December low for the Dow was 868.72 (Dec. 16). If the December low is broken in January, it is considered a bearish omen for the market. Therefore, watch 868.72.

In the last Letter I listed seven reasons for caution or bearishness regarding this market. These seven items still stand (they are still graded bearish). Here are some further comments:

(1) The bear segment of the 233-day cycle is now in place, and the bearish cycle influence will be in force into March.

(2) The odd-lot studies are now bearish. The market failed to climb as the odd-lot index showed heavy public selling during November-December. In fact, odd-lot selling reached a four-year high in December. I expect the odd-lot selling to subside during January, and this should be accompanied by a lower stock market.

(3) The negative volume indices are now bearish, and this is amplified in another section of this Letter.

(4) And this one is particularly bearish: the advance-decline ratio on the AMEX has broken below the June low and even below the lows of 1980 – while the AMEX price average was attempting to rally. This is terrible action, denoting persistent distribution on the junior exchange.

Turning to the Primary Trend Index (PTI), we see some important new developments. In the last Letter I reported that the PTI had broken its latest rising trendline. This constituted a *first sell signal.* On December 22 (see chart) the PTI dropped below its 21-day moving average. This was a *second sell signal.* Note also that on the September-December rally the PTI failed to rally above its major declining trendline, a trendline that extends down from the June 23 high of 1510. Thus, the PTI (1) failed to reverse its major declining trendline, (2) broke its secondary ascending trendline, (3) fell below its 21-day moving average. I therefore grade the PTI bearish as to its major, secondary and minor trend.

The advance-decline ratio violated its rising trendline a week ago (see chart), and it too is in a declining trend. The September-December rally in the A-D was weak and unimpressive. My guess is that the September 25 low of minus 25.22 will be tested during January.

INVESTMENT POSITION: I'd really like to be a bull, but in order for me to be bullish, the markets have to look bullish. Unfortunately, they don't. Therefore, the bear continues to dominate in this box. My investment advice continues to be (as it has for many months) as follows: "Put your money in 91-day Treasury bills, and roll the bills over into new 91-day denominations when and as they come due."

A glance at the funds, the commodity traders, the bond holders, the real estate speculators, and you'll see a predominance of one thing over the last year – red ink. On the other hand, my subscribers should have averaged returns of about 12% to 13% in the bills. Which is pretty good. Of course, in staying with the bills you did miss the thrill and excitement of losing your money in

any of a dozen other markets. But remember, I run this publication for the edification and (hopefully) the profit of my subscribers, and I never promised you "an exciting time."

233 DAY CYCLE: Older readers know that I have identified a 233-day cycle which seems to hold sway in the stock market. The cycle breaks up into two segments, a 144-day bull segment and an 89-day bear cycle. Just as all living matter breathes (inhalation and exhalation), so the market animal breathes too. It is this breathing that produces the 233-day cycle (I liken inhalation to the bearish segment of the cycle, and exhalation to the bullish segment).

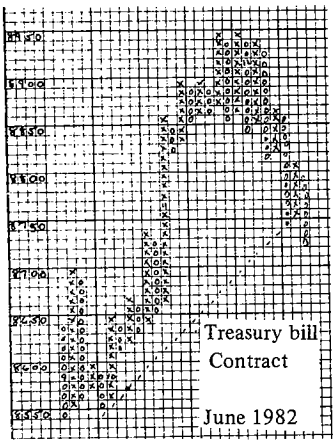
I identified the low point of the last (H) cycle as the July low of 924.66. This shows as the L (low) point on the chart at the end of the H cycle. From that point, the bull segment of the I cycle began. I have been saying all along that the bull segment of the I cycle was due to end around the middle of December. So far, that projection would seem to be right on target (see chart below).

On December 4 the Dow Industrial Average recorded a high of 892.69. The Average then backed off before a second rally to 886.51 (Dec. 11). Following the mid-December surge, the Dow and the rest of the market tumbled to lower levels. At this point, I am labeling the December 4 Dow high of 892.69 as the peak of the bull segment of the I cycle. The bear segment of the I cycle should now be underway, and the bear cycle is due to carrry into March.

Note that the bull segment of the I cycle began at 924.66 (July). The bull segment of the I cycle ended on December 4 at 892.69. Thus there was a NET LOSS during the bull cycle of 32 points during the total run of the bull cycle. This was the poorest performance of any cycle since the end of the B cycle in mid-1977. During the 9 total cycles that have appeared since 1976, only two showed net losses during their bull phase. This kind of weakness is usually followed by further weakness – and that does not bode well for the first quarter of 1982.

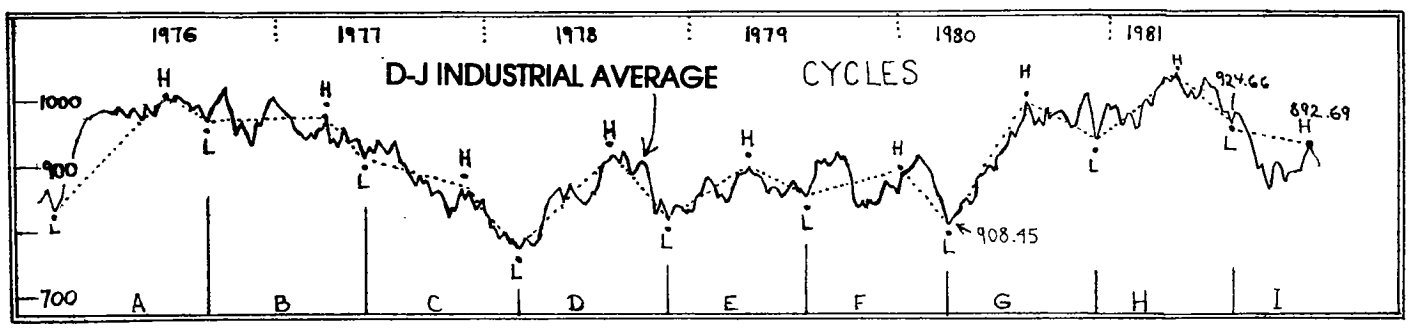
Opinion: We've seen the lows on the bonds and the bills, and from here on interest rates should start climbing aggresively. When those who bought bonds over the past few months realize they've been caught in a bear market rally, they're going to want to get out. At that time (with all due respect to Merrill Lynch's bond "bull market"), we could see a panic in the money markets. Municipal bonds, by the way, are now flirting with their lows or, in many cases, making new lows.

This chart (at right from *Chartcraft*, Larchmont, NY 10538) shows the large top that has formed in the Treasury bills (June contract). The T-bill contracts are structured so that as the contract price of the bills drop, the yields on the bills rise. Thus we see a good top here on the bills (bottom for interest rates), and a breaking of the bullish trendline.



NEGATIVE VOLUME: Over the years I have written a good deal about the negative volume studies. These studies were originated by Paul Dysart of *Trendways,* an investment service out of Louisville. Dysart died many years ago, but I have always kept up his studies of negative volume.

The theory behind negative volume is that *informed money* prefers to buy in quiet markets. Conversely, the public (uninformed money) operates on its emotions, and therefore the public tends to buy in frothy or excited markets. One of the keys to the classification of the markets is volume. In order to break the market down into quiet or excited markets, Dysart used volume. Quiet or investment-oriented markets, reasoned Dysart, are those in which volume DECREASES compared to the preceding day. Excited markets are those where volume expands over the previous day.

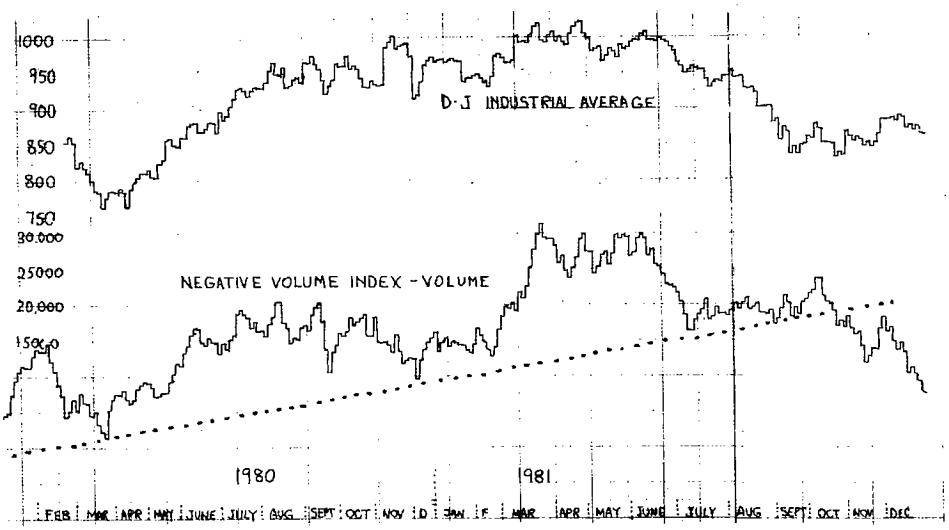


INTEREST RATES: I've been warning money market optimists that the recession is going to produce a huge short-fall in Government tax receipts (because of a contraction in corporate profits and individual income). Each Treasury auction is bigger than its year-ago counterpart, and one estimate is that the Treasury will have to raise $40 billion in new money in first quarter 1982.

Tom Holt now estimates that "corporate income taxes are accruing in the current quarter at an annual rate of $64 billion or $21 billion *below* a year ago. Most of these taxes are payable next March. Thus, the Treasury will find its receipts in the 1982 first quarter to be far, far below projections. Government financing will be monstrous, as a result."(Holt Advisory, 290 Post Rd. West, Westport, CT 06880).

Dysart kept two sets of indices. The positive volume index followed the *differentials* in the advances and declines on days when volume was up over the preceding day. And the negative volume index followed the advance-decline differentials on days when volume was down below the preceding day. The negative volume index, reasoned Dysart, was the more important, since this revealed what informed investors (those who prefer a quiet atmosphere) were doing.

I keep three negative volume indices. One is based on advance-decline differentials, one is based on upside-downside volume differentials, and one is based on price changes in the S&P 500. All entries are made ONLY on days when volume is below the preceding day. Thus, if volume is rising all week and is down on



Friday only, then just one entry is made on the negative volume charts that week.

I've been watching the negative volume indices carefully of late, and this is why. Negative volume based on the advance-decline differentials has been very weak, and last week it broke to a new low, the *lowest ever* on my chart. Negative volume based on S&P 500 changes is also weak and is breaking down dramatically. The holdout has been negative volume based on the upside-downside volume differentials.

I have included a chart of the latter (above), and here we see that the volume differential index was in a definite rising trend during 1980 and through 1981 up to March. In March this index surged to the upside, and then formed a sideways pattern into June. In June the Index dropped precipitously, but the long rising trendline continued to hold. The trendline held intact until last October.

During October, as seen on the chart, the negative volume index based on upside-downside volume differentials plunged below its rising trendline and also below all lows going back to early 1980. Thus, the last of the negative volume indices has broken down.

Conclusion: The bearish signal given by the three negative volume indices is telling us that *informed money has been leaving* the market. So far, this has shown up mainly on the various advance-decline lines. Note the weakness of the NYSE A-D as seen on the page 2 chart. On the AMEX the breadth weakness has been even more dramatic. As stated earlier, the A-D on the AMEX has broken down badly, and as of last week the AMEX A-D line was at its lowest level since early 1980. Thus the negative volume indices (and they tend to be *lead* indices) are reflecting and forecasting declining market breadth.

GETTING RICH: One of the questions that I am most often asked is, "How can I make a pile of money?" or "How can I get rich?" A simple, direct question, right? So is there a simple answer?

A few years ago a senior vice-president of *Harris Trust Corp.* named Fred Young wrote a fine book entitled, *How to Get Rich and Stay Rich.*" Many of Young's ideas jibe perfectly with mine, so I'm going to repeat "our" formula for getting rich. Mind you, I'm far from convinced that everybody needs to get rich, and I'm not even sure that getting rich is good for certain people. Be that as it may, here are the ideas for getting rich.

(1) Marry a millionaire. There's one caveat here . . . make sure that you are in love with this "human treasure trove of wealth."

(2) Inherit millions. There is (alas) nothing you can do about picking wealthy parents, but this is, nevertheless, one of the ways people become rich. As an aside, I'm not sure that inheriting wealth is good for your psyche – but that's another story.

(3) Spend less than you earn, and invest the difference intelligently. Fred Young's list of where to invest your hard-earned money is interesting. (a) Invest it in real estate, although in my opinion, it is probably rather late for real estate. With mortgage rates at 17%, most real estate provides a negative cash flow. (b) Invest it in your own business. This is probably the BEST idea – assuming you have the talent and brains to run your own shop. (c) Invest it in common stocks during a primary bull market. (d) Invest it in T-bills, T-notes, money market funds, etc., and then let the "magic of compound interest" make you rich. This requires patience and the ability to stick to a preconceived plan. It is also the *surest* road to riches. This plan is particularly timely today – in this era of historically high interest rates.

Aside from the "boundless joys" of being a millionaire, it is an ironic fact that every method and manner of being or getting rich involves a SACRIFICE. For instance, marrying a millionaire means that you will never have the pleasure of making that first million yourself. And you will therefore never know whether you could have done it "on your own." And don't kid yourself, doing it on your own is a great builder of confidence and a great source of satisfaction. The man or woman who got it "the easy way" often suffers from guilt and feelings of "I don't deserve it." And ironically (or should I say karmic-ly) the easy way often turns out to be not so easy.

Even those who make it themselves have to go through sacrifices. If you make your millions through investments you have to endure the agonies of finding out whether those investments are winners or losers. If you make your millions in your own business you will probably spend long, arduous hours competing in the world of hard knocks. I don't think I ever met a self-made millionaire who claimed "it was easy." It may have been fun, but it was never a snap.

How about the person who makes millions via compounding money at high interest rates? This requires the sacrifice of time and the discipline of steady, year-after-year saving. Very few people have the strength of character to become wealthy via the compounding route. But with the rise of the modern pension fund, I believe we will see this method come increasingly to the fore.

Well, there is just one more item I want to add to this discussion. I am a firm believer in the principle that God gives us what we NEED, not what we want. I am also a firm believer in the thesis that we are here on earth for a definite purpose. That purpose is to gain wisdom and to advance spiritually. Therefore, we are given what we need in order to gain wisdom, and in order to advance. Where wealth may help a particular person, that person is given the opportunity to gain wealth. Where frustration and poverty may help another person, that person is denied wealth.

Where a middle income may take another person to some kind of fulfillment, that's what he'll get. And where grinding poverty may force this particular fellow to face certain facts, then grinding poverty may well be his fate.

"Where does free will and ability come in?" you ask. There is always free will, as there is always the potential to learn and advance. As man advances spiritually his fate will change. Thus, the bum who faces himself, perhaps has a revelation, changes his life . . . . that redeemed bum may end up as a leader of men, a success in the world. I believe that men and women can learn and that they can change their attitudes and their lives. And of course that, to my mind, is the beauty and the immense advantage of a free society. Such a society ALLOWS people to fulfill themselves and thereby reach their true destinies.

NOTES & QUOTES: As you can see from this news clip, San Diego workers have voted to get out of the Social Security System. Alas, those of us in private industry are not so lucky – we can't vote to get out. Personally, I'd pay a fee monthly to be able to exit from the system. Maybe that's the magic answer for the Government, charge participants say $10 a month for the privilege of backing out of Social Security. I predict they would be flooded.

By Reginald Smith
Tribune Staff Writer

In what amounts to a vote of no confidence in the future of Social Security, more than half the city's employees have endorsed withdrawal from the financially troubled system for a plan that guarantees them more control over their retirement investment.

The City Council was expected to approve the Dec. 31 withdrawal today. It would affect all city employees who have been in the system for less than five years.

Most of the employees who voted to withdraw said they had little confidence in the security of the federal system but were confident that few benefits would be left by the time they were eligible to receive them.

"I have no faith in Social Security," said Nancy Angotti, deputy city clerk. "By the time I retire, the benefits will have reduced to a point where there is nothing left for me.

"With the new system, I have some control and access to my money. In Social Security, I have to take what they give me."

About three years ago the city no-

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Auto facts: one out of every 6 workers in the nation has an auto industry connected job. The Commerce Dept. has just announced the one million workers in the depression-plagued auto industry and its suppliers are now out of jobs. For years US auto makers caved in to the unions on wages. Now Japanese auto makers have an $8 an hour wage advantage over US makers. The average Japanese car can be produced at about $1500 below US costs. Next year (1982) is the year of new union contracts for the US auto makers. It promises to be a fateful year for both unions and manufacturers – at stake is the very existence of the American auto industry.

* *

Next Detroit?

After a number of technological and production breakthroughs, the Japanese are threatening to take over the semi-conductor industry. Governor Brown, who presides over one of the nation's least-friendly-to-business states, took note of this in a recent speech.

SAN JOSE – The Japanese threaten to make Silicon Valley's high-technology industry "the next Detroit," Gov. Brown warns.

Japan's electronic industry is determined to get control of the high-technology market while U.S. industry hangs back, Brown warned 600 Rotarians and guests Wednesday night.

Brown told his mainly conservative audience that the Japanese march on the U.S. semiconductor industry must be blocked, partly through higher taxes.

Poland owes Western banks piles of money, $2.4 billion of which is due at the end of this year. Not only can't Poland pay, but Poland can't even pay $500 million in interest that is due Western banks this year. So what does Poland do? Last week it asked 20 Western banks to loan it an additional $350 million in order to help it pay the $500 million due. Needless to say, the banks said "no." Question: What ever happened to the bank officers who originally OK'd the Polish loans? Answer: nothing. I've never seen a single mention of an officer responsible for the Polish loans – or any other collapsed foreign loans, for that matter.

* *

You can't get blood from a stone. And you can't reduce taxes in the face of a huge military build-up and come away with anything less than huge deficits. Even the Administration is beginning to see this. As witness this UPI news clip from last week:

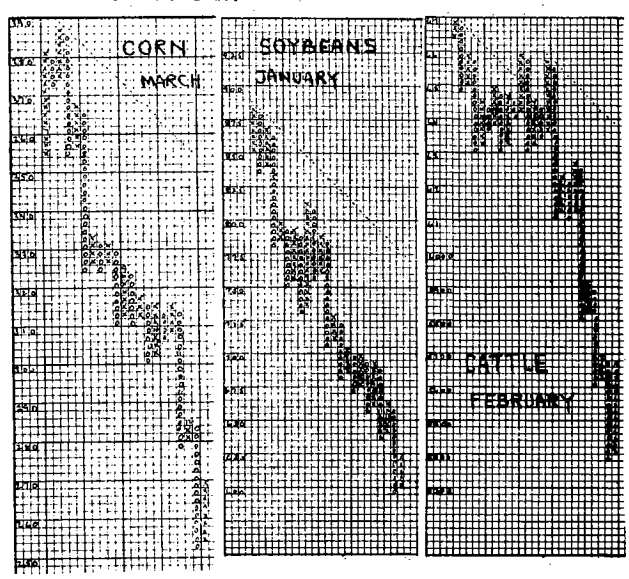
WASHINGTON (UPI) – A White House spokesman yesterday confirmed reports President Reagan, despite repeated vows not to raise taxes, will be urged this week to approve huge tax increases to minimize the growing deficit.

Other administration sources confirmed that a $45 billion tax increase proposal does exist and has been under consideration since November.

White House spokesman Larry Speakes said "there will be some tax increase proposals," but would not comment on a New York Times report that said the Treasury Department, the Office of Management and Budget and top economic advisers are backing a proposal to raise taxes by $15 billion in fiscal 1983 and $30 billion in 1984.

* *

Down On The Farm: These P&F charts (courtesy of *Chartcraft*) give you some idea of the absolute slaughter that has been taking place on the commodities front. This, in case you didn't know it, is not inflationary. And it's a disastrous situation for US farmers. In many instances, farm land is now worth more than the crops that are produced on them can bring. This will mean lower prices for farm land in due time.



From our "I don't Believe This Dept."

CHICAGO – The unveiling of U.S. industrial robots in Japan in 1967 "was a great shock to our own engineers," a Japanese robot expert told a group of U.S. managers recently.

But since then, Japan has recovered from the shock to install an estimated 10,000 robots in its factories, while the United States has only 4,000 to 5,000.

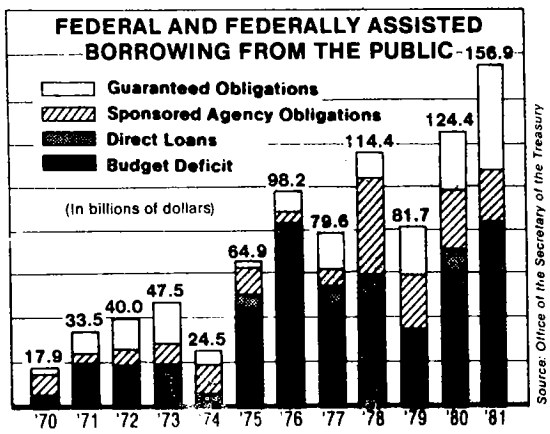
So why did Japan catch "robot fever" and the United States didn't?

Ironically, said Toshio Sata, professor of engineering at the University of Tokyo, part of the reason may be because the average Japanese thinks robots "came from the United States, so they must be good."

* *

You think you know what our Government is spending. Forget it, you only know what they want you to know. On top of the regular budget spending, Washington eats up money in guaranteed obligations, and sponsored Agency obligations. The Agency borrowing is engineered through the Federal Financing Bank, which was established in 1973. The Bank borrows at a price just 1/8 point above Treasury borrowing, then lends to the agencies at almost cost. Although the Bank's borrowing doesn't go into the announced Federal budget, the ultimate deficits produced by the Bank do go into the final Federal deficit figures. I've said before and I'll repeat, the Federal Financing Bank is a scam – and it should be abolished. If the Agencies want to borrow, let them go into the markets and borrow like anyone else, and let their borrowing be part of the US budget!

This chart gives you some idea of the total Federal borrowing in the money markets. Since 1980 total Government borrowing has increased 776%.



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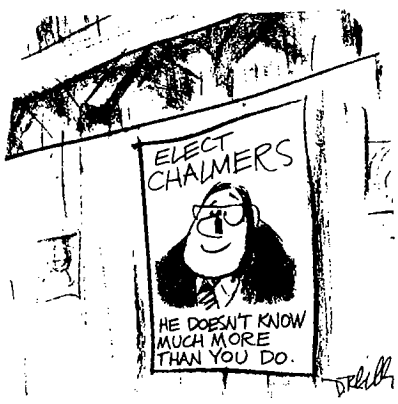
And a Merry Christmas and Seasons Greetings to all my subscribers. I hope these Letters stood you in good stead during 1981 – or at least that they helped to keep you out of trouble. I enjoyed writing them, and from letters received here I gather at least a few people enjoyed reading them. Many thanks.

NEXT MAILING: Jan. 13

Here's a parting shot for all you politicians (courtesy the *New Yorker*).



GOLD: "Gold, gold, are you going to fold?" Well, just about everybody does expect gold to fold, and now we are told (and I'm sure it's true) that the Russians are selling large quantities of gold. The line of support for gold seems to be 400. Each time 400 is fractionally penetrated buying seems to come in and gold pops above 400 again. The second line of support is the 1981 low of 392, which is only a fraction of a percent below 400.

What do I think of gold? Technically, the bear is in charge. The statistics for the three moving averages of gold are as follows: the 5-week MA is 411, the 13-week MA is 418, and the primary or 50-week MA is at 457. Currently, gold is below all three MA's. Thus, on a strict technical interpretation the trend for gold is down.

Bears on gold note that the metal has done little in the face of the Polish crisis, the Afghan crises, and the Sadat assassination. Bulls on gold point out that in the face of a commodity crash, deflationary tendencies in the economy, high interest rates and general bearishness towards the metals, gold has refused to break significantly below 400.

My own assessment is this: I will be surprised to see gold drop significantly below 392. But if it does, I would say that the deflationary implications are ominous. If gold breaks down under 392, gold detractors will shortly witness a situation that will not be to their liking.

Of interest is this monthly ratio chart of gold going back to 1967. The chart very clearly shows the decade-long rising (primary) trendline that has pointed gold upward since 1970. Note also the secondary bullish trendline that has been in existence since the 103 low of 1976.

This secondary trendline was violated this year when gold broke below 400. If gold were to make contact with the main trendline in 1982, we could see a price of as low as 300 without the main trendline being violated. Thus, gold has a huge leeway as far as the secondary trend is concerned – a huge leeway before one could say with any authority that the primary trend of gold has turned down.